New Generation Coop Patronage – Passive or Active Income?

During the tax preparation season in early 2006 and this fall’s tax schools, it became evident there was and continues to be substantial uncertainty regarding whether the income paid out by new generation cooperatives should be reported as passive income or non-passive. This issue is particularly debated for situations where the cooperative is a member of an LLC (where the LLC is the entity that owns and provides the management for the value-added business).

Most tax professions concur that the Regulations and case law require patronage paid from a 100 percent farmer-owned cooperative, which is the owner/manager of the production facility, to be reported according to the character of their farm income.

It has taken awhile, but I think we now have some clarification regarding the issue involving a cooperative which is a member of an LLC. My investigation suggests that the cooperative’s obligation for providing corn to the LLC provides sufficient “direct relationship” with the producing LLC entity to prevent the resulting income from being characterized as passive.

Thus, the income is not passive income from the LLC to the cooperative and the payment of patronage from the cooperative to its members would not be considered passive income.

I am continuing to develop the documentation for this position but wanted to share the current results of this investigation, as many preparers are in the process of assisting clients estimate their 2006 tax liability.

I will post additional details and documentation as they become available.

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